

FISCAL NOTE

Bill #: HB0750

Title: Increase cigarette tax; appropriate general fund and coal trust principle

Primary Sponsor: Brown, R

Status: As Amended

Sponsor signature	Date	Chuck Swysgood, Budget Director	Date
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Fiscal Summary

	FY 2004	FY 2005
	<u>Difference</u>	<u>Difference</u>
Expenditures:		
General Fund	\$37,597,012	
Other - Coal Severance Tax Trust Fund	\$29,000,000	
Revenue:		
General Fund	\$51,056,466	\$19,455,430
State Special Revenue - Long Range Building Prog	(\$109,077)	(\$133,789)
State Special Revenue - DPHHS Vets Home	(\$78,671)	(\$95,928)
Other - Coal Severance Tax Trust Fund	\$3,758,738	\$3,649,507
Net Impact on General Fund Balance:	\$13,459,454	\$19,455,430

- | | |
|---|--|
| <input type="checkbox"/> Significant Local Gov. Impact
<input type="checkbox"/> Included in the Executive Budget
<input type="checkbox"/> Dedicated Revenue Form Attached | <input checked="" type="checkbox"/> Technical Concerns
<input checked="" type="checkbox"/> Significant Long-Term Impacts
<input type="checkbox"/> Needs to be included in HB 2 |
|---|--|

Fiscal Analysis

ASSUMPTIONS:

Cigarette Tax Revenue Impacts

1. The current law cigarette tax rate is 18¢ per pack; under this proposal, the cigarette tax rate is increased to 65¢ per pack beginning July 1, 2003.
2. Under current law, wholesalers are entitled to discounts on the purchases of tax insignia equal to 6% of the full face value of the insignia (tax) for the first 2,580 cartons purchased; 4% for the next 2,580 cartons purchased; and 3% for purchases in excess of 5,160 cartons. Under this bill these discount rates drop to 1.77%; 1.19%; and 0.89%; respectively. The changes to the discount rates provided for in this bill will maintain total discounts received by wholesalers at current law levels.
3. Under current law, cigarette tax revenues, after tribal revenue sharing payments, are distributed 73.04% to the state general fund; 15.85% to the long-range building program account; and 11.11% to the Department of Public Health and Human Services for the operation and maintenance of state veterans' nursing homes.
4. Under this proposal, cigarette tax revenues, after tribal revenue sharing payments, are distributed 82.19% to the state general fund; 4.36% to the long-range building program account; and 3.05% to the Department of Public Health and Human Services for the operation and maintenance of state veterans' nursing homes;

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and 10.4% to the coal severance tax trust fund. After June 30, 2013 the percentage distributed to the state general fund increases to 92.59% and no amount is distributed to the coal severance tax trust fund.

5. The above changes generate net new revenue of \$25,511,708 in fiscal 2004 and \$24,594,418 in fiscal 2005 from the cigarette tax.
6. Revenue to the *state general fund* will *increase* by \$21,940,869 in fiscal 2004 and \$21,174,636 in fiscal 2005.
7. Revenue to the *long-range building program account* will *decrease* by \$109,077 in fiscal 2004 and \$133,789 in fiscal 2005.
8. Revenue to the Department of Public Health and Human Services for the operation and maintenance of state *veterans' nursing homes* will *decrease* by \$78,671 in fiscal 2004 and \$95,928 in fiscal 2005.
9. Transfers from the cigarette tax to the *coal severance tax trust fund* will total \$3,758,738 in fiscal 2004 and \$3,649,507 in fiscal 2005.
10. The impacts in assumption five are calculated using a model developed by the Department of Revenue (DOR). The Revenue and Transportation Committee (RAT) cigarette tax revenue estimate under current law for fiscal years 2004 and 2005 is used as the base. In addition to RAT's base estimate, a price elasticity of demand for cigarettes of 0.44 is used in this model. The model assumes the price of a pack of cigarettes will increase by the same amount (in dollars) of a tax increase. Given a base cost of \$3.21 per pack, which is used in this model, and an elasticity of 0.44, each penny increase in the price of a pack of cigarettes results in a decrease in demand of 0.14%.
11. The cigarette tax impacts provided for in this fiscal note include impacts associated with the price elasticity of demand for cigarettes, but do not include forecasts of declines in consumption of taxable cigarettes due to Internet sales of cigarettes, the impacts of current and future local government resolutions providing for non-smoking ordinances, or the effects of future increased tobacco prevention programs.
12. The following table shows the summary of the impacts from the cigarette tax increase under the assumption that there will not be significant stockpiling of cigarettes taxed at \$0.18 per pack. Section 5 of the bill is assumed to substantially mitigate any incentive for significant stockpiling of cigarettes.

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Table 1
HB750 (2003 Session) 3rd Reading
Cigarette Tax Rate Increase Impacts¹

	FY2004	FY2005
Tax Rate		
Tax Rate - Current Law	\$0.18	\$0.18
Tax Rate - Proposal	\$0.65	\$0.65
Tax Increase of:	\$0.47	\$0.47
Price		
Price - Current Law	\$3.21	\$3.21
Price - Proposed Law	\$3.68	\$3.68
% Change In Price	14.64%	14.64%
Consumption - Pack of Cigs.²		
Consumption - Current Law	60,444,444	59,688,889
Consumption - Proposed Law	56,550,391	55,843,511
Change In Consumption	(3,894,053)	(3,845,378)
% Change In Consumption	-6.4%	-6.4%
Net Revenue³		
Revenue - Current Law	\$ 10,630,000	\$ 10,497,000
Revenue - Proposed Law	\$ 36,141,708	\$ 35,091,418
Change In Revenue	\$ 25,511,708	\$ 24,594,418
% Change In Revenue	240.0%	234.3%
Current Law Distribution		
General Fund (73.04%)	\$ 7,764,000	\$ 7,667,000
LRBP (15.85%)	\$ 1,684,855	\$ 1,663,775
DPHHS (Vet. Nursing Homes) (11.11%)	\$ 1,180,993	\$ 1,166,217
Proposed Law Distribution		
General Fund (82.19%)	\$ 29,704,869	\$ 28,841,636
LRBP (4.36%)	\$ 1,575,778	\$ 1,529,986
DPHHS (Vet. Nursing Homes) (3.05%)	\$ 1,102,322	\$ 1,070,288
Coal Severance Tax Trust Fund (10.4%)	\$ 3,758,738	\$ 3,649,507
Change in Revenue		
General Fund	\$ 21,940,869	\$ 21,174,636
LRBP	\$ (109,077)	\$ (133,789)
DPHHS (Vet. Nursing Homes)	\$ (78,671)	\$ (95,928)
Coal Severance Tax Trust Fund	\$ 3,758,738	\$ 3,649,507

¹The impacts are calculated on the basis that there will not be significant stockpiling by wholesalers and retailers, and there will not be significant amount of illegal sales of cigarettes.

²Consumption (packs) is estimated using gross collections as the base.

³Net revenue is gross revenue minus tribal payments and discounts.

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Coal Tax Trust Impacts

13. In fiscal 2004, \$3,758,738 in cigarette tax revenue would be deposited in the coal severance tax permanent fund. Deposits would be made in approximately even monthly amounts. The average balance for the year would be increased by the average monthly deposit multiplied by the average fraction of a year remaining when each deposit is made. This is 11/24 of total deposits for the year. The interest rate earned on the trust fund is projected to be 6.71% in fiscal 2004. Interest earnings deposited in the general fund would be increased by \$115,597 ($6.71\% \times (11/24) \times \$3,758,738$).
14. In fiscal 2005, \$3,649,507 in cigarette tax would be deposited in the coal severance tax permanent fund. This would increase the average balance by \$5,431,429 ($\$3,758,778 + (11/24) \times \$3,649,507$). The interest rate earned on the trust fund is projected to be 6.79%. Interest earnings on these additional balances would be \$368,794 ($6.79\% \times \$5,431,429$).
15. This bill would authorize a transfer of up to \$29 million from the coal severance tax trust fund to the guarantee account before the end of fiscal 2004. The Office of Budget and Program Planning would determine the amount and timing of any transfers. This fiscal note assumes that \$29 million would be transferred at the end of fiscal 2004.
16. To obtain funds for the transfer, the Board of Investments would sell \$29 million in bonds that it holds in the Trust Fund Bond Pool and reduce the coal severance tax permanent fund's holdings of Trust Fund Bond Pool shares by \$29 million. The projected interest rate on the Trust Fund Bond Pool for fiscal 2005 is 7.2%. This is higher than the interest rate for the coal severance tax trust fund because part of the trust fund portfolio consists of below-market-rate loans to Montana businesses. This transfer would reduce interest earnings paid to the general fund by \$2.088 million in fiscal 2005 ($7.2\% \times \$29$ million). The net effect on interest earnings to the general fund would be a reduction of \$1,719,206 ($\$2,088,000 - \$368,794$).
17. Interest rates are projected to increase between now and the end of fiscal 2004. For every 1 percentage point increase in interest rates, the market price of bonds in the Trust Fund Bond Pool portfolio is projected to decrease by 7%. The yield on new 30 year Treasury bonds was 4.779% on December 31, 2002 and is projected to increase to 6.3939% on June 29, 2004. If this occurs, the Trust Fund Bond Pool would incur losses of approximately \$1.56 million on the sale of assets with a market value of \$29 million.
18. Realized capital gains or losses of the Trust Fund Bond Pool are distributed as part of the earnings of the trust funds that own shares of the pool in proportion to their holdings. The coal severance tax permanent trust and the school trust own about two-thirds of the shares. About two-thirds of any loss would show up as lower trust fund earnings going to the general fund and the guarantee account. About one-third would show up as lower earnings on other state trust funds.

Appropriations and Administrative Impacts

19. This bill provides for general fund appropriations totaling \$37,597,012 for the fiscal biennium beginning July 1, 2003 and ending June 30, 2005.
20. The Department of Revenue would incur costs relating to the change in cigarette tax rate, but they would not be significant.

FISCAL IMPACT:

	FY 2004	FY 2005
<u>Expenditures</u>	<u>Difference</u>	<u>Difference</u>
Operating Expenses	\$37,592,012	0
Transfers	<u>\$29,000,000</u>	<u>0</u>
TOTAL	\$73,592,012	

Funding of Expenditures:

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General Fund (01)	\$37,592,012	\$0
Trust Funds(09)		
Coal Tax Permanent Fund	<u>29,000,000</u>	<u>\$0</u>
TOTAL	\$76,592,012	\$0

Revenues:

General Fund (01)	\$51,056,466	\$19,455,430
State Special Revenue (02)		
Long Range Building Program	\$(109,077)	\$(133,789)
DPHHS - Veterans Home	\$(78,671)	\$(95,928)
Federal Special Revenue (03)		
Trust Funds(09)		
Coal Tax Permanent Fund	\$3,758,738	\$3,649,507

Net Impact to Fund Balance (Revenue minus Funding of Expenditures):

General Fund (01)	\$13,459,454	\$19,455,430
State Special Revenue (02)		
Long Range Building Program	\$(109,077)	\$(133,789)
DPHHS - Veterans Home	\$(78,671)	\$(95,928)
Federal Special Revenue (03)		
Trust Funds (09)		
Coal Tax Permanent Fund	\$(25,241,262)	\$3,649,507

LONG-RANGE IMPACTS:

Under this bill, transfers of cigarette tax revenue to the coal severance tax trust fund total around \$3.7 million per year in the 2005 biennium. The tax rate and distribution percentages provided in the bill for the period after the 2005 biennium should continue to provide for transfers of this general magnitude. However, annual transfers in future years will depend on population growth, future consumption patterns, and other factors affecting the purchase of cigarettes. Interest earnings to the general fund would be reduced until cigarette tax deposits to the coal severance tax trust fund equal \$29 million. If deposits exceed \$29 million before they stop at the end of fiscal 2013, interest earnings to the general fund would be greater than under current law from that time on.

TECHNICAL NOTES:

1. The coal severance tax trust fund consists of several subfunds. This bill does not specify which subfund or subfunds the transfer is to be made from. It also does not specify who is to make that decision. This fiscal note assumes that the transfer would be made from the permanent fund. If part of the transfer were from the Treasure State Endowment Fund or the Treasure State Endowment Regional Water System Fund, the reduction in interest earnings would be divided between the general fund, the treasure state endowment program, and the regional water system program in the proportion that funds were transferred from each subfund.